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Poland: The Economy on the Eve of the Party Congress

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An Intelligence Assessment

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ER 81-10254
July 1981

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Poland: The Economy on the Eve of the Party Congress [redacted]

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An Intelligence Assessment

Information available as of 10 July 1981 has been used in the preparation of this report.

This paper was prepared by the Eastern Europe and Soviet Trade Branches, USSR/Eastern Europe Division, Office of Economic Research. Comments and queries are welcome and may be addressed to the Chief, USSR/Eastern Europe Division, OER, on [redacted]

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Poland: The Economy on the Eve of the Party Congress

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Key Judgments

Poland's party congress convened against a backdrop of sharp economic decline that has become considerably worse in the past few months. Warsaw's precarious financial situation has also deteriorated in recent weeks. Although Poland has the basic strengths required to sustain an economic renewal, the Kania government has not been able to convince workers or farmers of its competence or good faith. Labor unrest has flared anew.

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Poland's economic problems are basically supply-side phenomena:

- An external financial squeeze is forcing deep cuts in imports, depriving an already unbalanced economy of vital raw materials and intermediate products.
- Manhours worked are also down markedly because of a shorter workweek and pervasive absenteeism.

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Though the regime is trying to minimize the impact of the decline on the consumer, the standard of living is clearly falling. Shortages of food and nearly all essential consumer goods remain severe, and the regime forecasts a 6-percent drop in per capita consumption this year.

Even with the extensive debt relief it has already received, Poland still faces debt service obligations of about $2 billion in the second half of 1981. Because hard currency imports are now running about $500-600 million a month, Warsaw cannot cut back enough to cover a significant portion of this bill without causing another sharp decline in domestic economic activity and in supplies of critical consumer and industrial goods.

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Some sort of suspension of debt service payments seems likely in the next few months:

- The Soviets apparently have no intention of providing more hard currency aid.
- Western banks have adamantly refused to increase their net Polish exposure.
- Western governments still seem unprepared to extend further large-scale aid.

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Poland has the basic ingredients to power an economic recovery—namely, a skilled labor force and an abundant supply of many natural resources (notably coal). Furthermore, with GNP in its third year of decline, Poland

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can tap an ample margin of unused capacity. Economic revival, however, depends on: 25X1

- The Soviets staying out.
- Substantial new loans both from the West and the USSR.
- Prompt recovery in farm output.
- The government's success in gaining control over the economy and winning the trust of a suspicious populace.

Meanwhile, the USSR has been trying to forestall economic chaos and maintain its influence with the Polish government by providing substantial economic assistance. In deciding whether the political situation is past saving and requires intervention, Moscow will have to take into account the prospect of the largest Soviet military operation since World War II, a lengthy military occupation that would complicate enormously Soviet security objectives, an indefinite chill on both political and economic relations with the West, and the large cost of pacifying Poland and propping up the economy in support of a puppet regime.

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Poland: The Economy on the Eve of the Party Congress

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Background

Poland's party congress is taking place against a background of economic disarray and some revival of labor unrest. Aggregate output is running far below year-ago levels, and the regime predicts that national income for 1981 as a whole will drop an unprecedented 15 percent compared to 1980.

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The decline has been evident in all sectors. Industrial production, for example, has been trending downward since mid-1980, and in the first five months of this year fell below the level for the corresponding period in 1980 by almost 13 percent. The decline has persisted despite a marked decrease in labor strife in the second quarter. Inflationary pressures have been intensifying, with sagging production accompanied by rapidly rising wages. The one relatively bright spot in the Polish economic scene is agriculture, where—largely because of favorable weather and output-stimulating rises in procurement prices—the outlook is for increases in most crops, including grain.

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The depressed state of the Polish economy is basically a supply-side phenomenon. The financial squeeze is causing sharp cutbacks in imports, depriving Poland's already bottleneck-ridden economy of vital inputs. Labor inputs have also dropped sharply—manhours worked are running about 10 percent behind 1980—reflecting a shorter workweek and vastly increased absenteeism. Management can also be said to be in short supply. Disorganized and demoralized, the economic leadership has been unable to impose control over the economy. Nor has it been able to convince workers of its competence or good faith, the *sine qua non* of stimulating greater and more efficient work by the labor force. Despite sporadic signs of cooperation between Solidarity and the regime—in altering present rationing arrangements, for example—worker distrust of the leadership remains pervasive and intense.

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Table 1 *Percent*

Poland: Percentage Change in Aggregate Indicators

	1976	1977	1978	1979	1980
Gross national product [a]	2.3	1.7	3.7	−1.9	−2.6
Industrial production [a]	1.9	2.1	1.7	−1.3	−1.3
Agricultural production [a]	1.6	0.5	8.5	−5.8	−7.0
Investment outlays [b]	2.2	4.3	1.6	7.4	−12.7
Per capita consumption [a]	7.0	4.0	0.2	0.4	0

[a] Western estimate.
[b] Official Polish data.

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Economic Slide Continues

Industrial Output Slips Downward

Industrial production has been trending downward for about a year (see figure 1). A seasonally adjusted index constructed in the West shows that Polish industrial output moved sideways, although erratically, in the year preceding the mid-1980 strikes. It then plunged sharply in August 1980, recovered in September and October, and then turned downward again through April. A preliminary estimate based on industrial sales figures suggests that by May industrial output had fallen nearly 15 percent below the June 1980 level.

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Almost all industrial sectors, especially the consumer-related food, textile, and paper industries, showed declines in seasonally adjusted output from June 1980 to April 1981 (see figure 2). In addition, seasonally adjusted output in heavy industry decreased 12 percent and the production of electricity, chemicals, and ferrous metals fell 7 percent.

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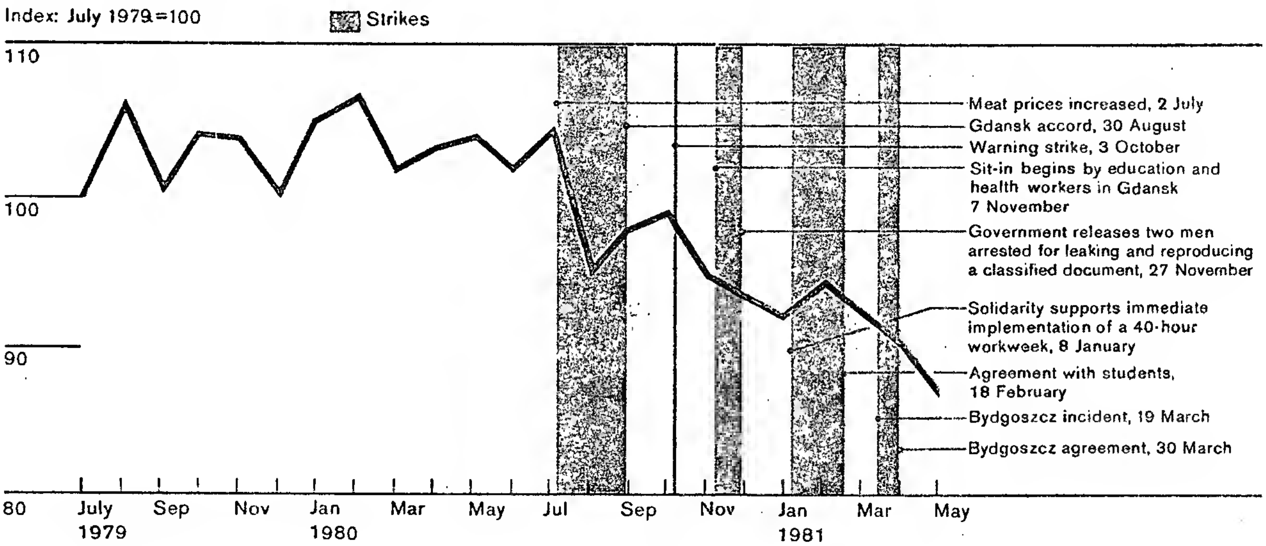
Figure 1

Poland: Industrial Production[a]



[a] Seasonally adjusted.

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Coal Output Falls

Particularly dismaying was the 22-percent decline in coal production in the first half of 1981 compared with January-June 1980. Coal output in January-June ran at about a 163-million-ton annual rate. Forecasts of 1981 coal production were revised downward last month to 165 million tons—15 percent less than last year and 5 percent below the minimum target set in the stabilization program presented to Western creditors. Actual production may well drop below this most recent forecast. [redacted]

Warsaw expected coal production to fall below 1980 levels this year because of a reduction in the number of working hours in the mines. In addition, many mines need preparatory and maintenance work because of the neglect of the last few years. Actual hard coal output, however, has declined faster than expected in recent months for several reasons:

- The government's decision—at Solidarity's urging—to reduce incentives to miners for Saturday work and to allow miners holiday time without additional makeup time on Saturday.
- Miners' displeasure with government decisions on political and work issues.
- A slight reduction—rather than the planned increase—in the number of mine workers. [redacted]

The dismal food supply situation is also contributing indirectly to the fall in coal output. Although miners presently receive larger than average allocations under Poland's food rationing scheme, they complain that they are not strong enough to work extra shifts because of inadequate food supplies. In response, the government last month began shipping extra food and cigarettes to miners in Silesia—where food is in particularly short supply. The government is also considering assigning military personnel to the mines to work the weekend shifts that miners now avoid. Nonetheless, miners continue to be dissatisfied. [redacted] miners have threatened to halve coal production unless Silesian food supplies reach a level comparable with other areas in the country. Seventy-seven coal mines and Solidarity chapters reportedly support the plan. [redacted]

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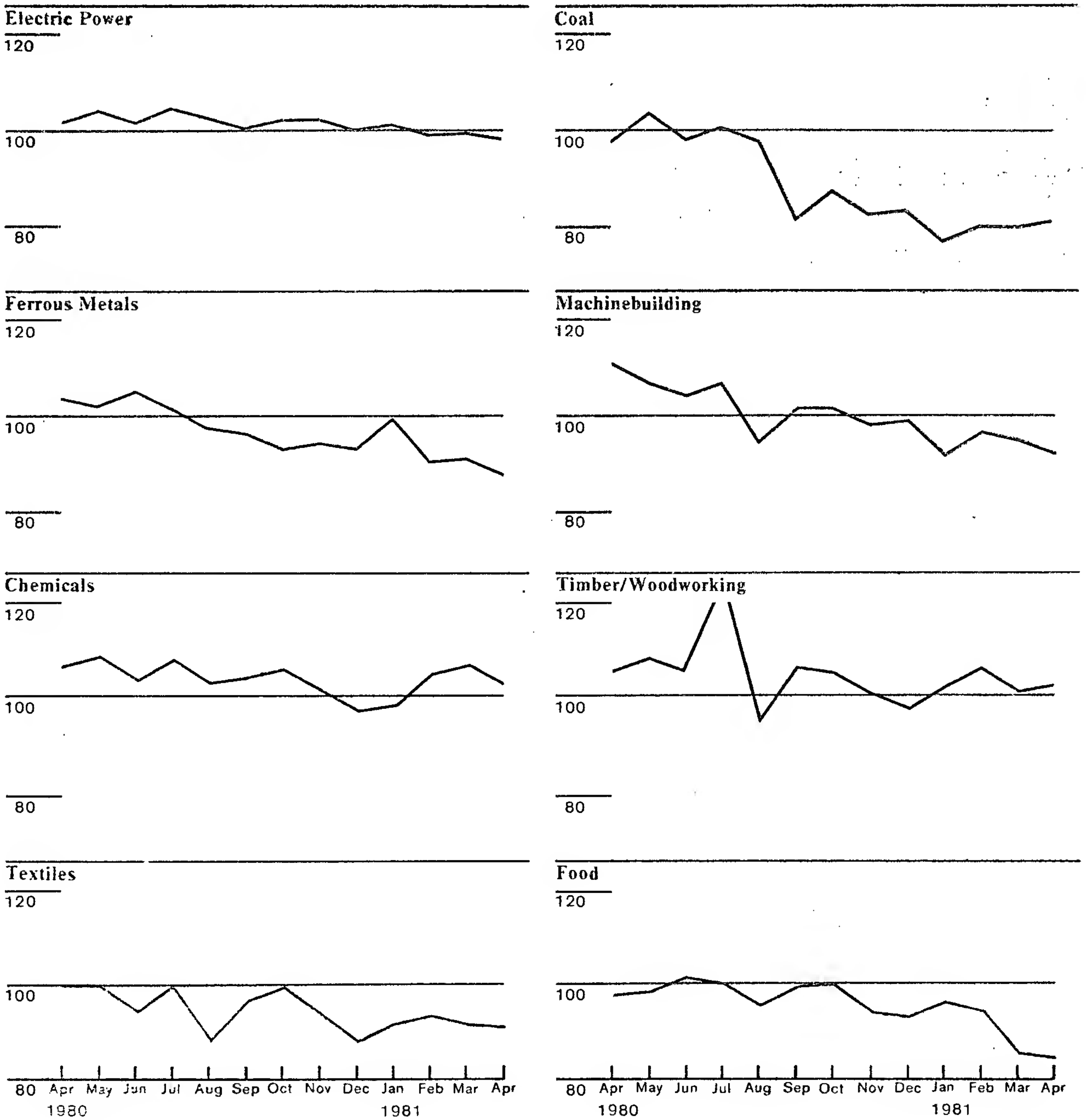
Figure 2

Poland: Production in Major Industrial Sectors[a]

Index: July 1979=100



[a] Seasonally adjusted.

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Table 2

Poland: Production of Key Commodities

	1978	1979	1980	January-April 1980	January-April 1981	Percentage Change Jan-Apr 1980 to Jan-Apr 1981
Consumer goods						
Meat (*million tons*)	2.5	2.6	2.5	0.9	0.7	−14
Milk (*billion liters*)	2.4	2.6	2.7	0.9	0.9	4
Butter (*thousand tons*)	258	252	252	66	46	−30
Spirits (*million liters*)	208	203	212	72	67	−7
Cigarettes (*billion*)	90.8	91.4	93.4	32.7	28.3	−13
Washing machines (*thousand*)	806	754	809	280	265	−5
Refrigerators (*thousand*)	891	765	692	248	214	−14
Radios (*million*)	2.6	2.7	2.7	0.9	1.0	10
Television sets (*thousand*)	972	915	896	332	303	−9
Artificial fibers (*thousand tons*)	252	244	256	90	79	−12
Paper (*thousand tons*)	1,069	1,010	1,032	357	331	−7
Cotton fabrics (*million linear meters*)	919	886	883	304	281	−8
Wool fabrics (*million linear meters*)	124	123	121	42	38	−10
Shoes (*million pairs*)	159	162	164	58	55	−5
Fuels and power						
Hard coal (*million tons*)	192.6	200.9	193.1	69.0	55.2	−20
Brown coal (*million tons*)	41.0	38.0	36.9	13.0	12.8	−2
Coke (*million tons*)	20.2	20.0	19.9	6.7	6.1	−9
Electricity (*billion kWh*)	115.6	117.5	121.9	43.5	41.9	−4
Metal products						
Crude steel (*million tons*)	19.3	19.2	19.5	6.6	6.0	−9
Rolled steel products (*million tons*)	13.6	13.6	13.6	4.6	4.2	−9
Building materials						
Cement (*million tons*)	21.7	19.2	18.4	6.6	4.9	−26
Chemicals						
Sulfuric acid (*million tons*)	3.2	3.0	3.0	1.1	1.0	−11
Fertilizers						
Nitrogen (*thousand tons*)	1,470	1,376	1,293	420	436	4
Phosphate (*thousand tons*)	1,026	931	842	312	299	−4
Polyvinyl chloride (*thousand tons*)	125	102	119	37	36	−3
Machinery and equipment						
Mining machinery (*thousand tons*)	285	354	369	129	109	−16
Metallurgical machinery (*thousand tons*)	74.1	74.5	59.9	21.4	16.3	−24
Machinery for the chemical sector (*thousand tons*)	78.1	78.4	74.2	26.6	20.9	−21
Machinery for the agricultural sector (*billion zloty*)	18.4	18.7	18.6	6.4	5.4	−15
Railway cars						
Passenger	383	320	328	122	84	−31
Freight (*thousand*)	17.9	15.9	15.2	5.3	3.9	−26
Passenger cars (*thousand*)	325.7	349.8	351.3	130	104	−20
Tractors (*thousand*)	59.5	54.2	57.4	20.0	18.6	−7
Sea-going vessels (*thousand DWT*)	742	602	392	147	98	−33

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Bottlenecks

Polish officials have attributed the sharp deterioration in all sectors primarily to lower labor inputs and shortages of industrial materials and spare parts imported from the non-Communist world. Because of a shorter workweek (now down to 42 hours from 44 hours) and a quantum jump in absenteeism (up 90 percent in January-May from the same period in 1980), manhours worked are running at least 10 percent behind 1980. Hard currency imports, in real terms, were at least 25 percent lower in January-May this year than in January-May 1980. All of the reduction has consisted of producer goods, imports of which are down almost 50 percent from 1980 levels. Imports of consumer goods from the West are up sharply, even in volume terms.

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These two output-depressing factors interact to some extent. Reduced manhours reflect in part involuntary loss of worktime because of productive capacity rendered inoperative by lack of material inputs. Decreases in imports and reductions in manhours, however, apparently have been largely independent of each other. The shorter workweek and rising absenteeism have stemmed mainly from political developments; and cuts in imports from the West primarily reflect efforts to conserve increasingly scarce hard currency.

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To some degree, reduced imports from the West have been offset by increased shipments from the Communist world, chiefly the USSR. The volume of imports from Communist sources, which rose by about 35 percent in 1977-80, increased by about 10 percent in January-April 1981 over January-April 1980. Substitution, however, is at best highly imperfect. Examples of bottlenecks created by depriving Polish industry of Western imports abound:

- In the coal-mining sector, some mines were forced to close because of the lack of imported steel chains used in the mining process.
- In light industry, shortages of imported cotton to make textiles have idled plants.
- In the chemical sector, production of pharmaceuticals has fallen because of the cut in chemical imports from the West.
- In the machine-building sector, a factory producing color television sets was forced to close because of the inability to import a few million dollars of raw materials, underscoring the disproportionate impact of withholding even small amounts of foreign exchange.
- In the food industry, several major fish processing plants reportedly closed because of the lack of hard currency to import tin for canning fish.

According to Minister of Foreign Trade Karski, some industrial sectors are working at 20 to 30 percent of capacity because they have no money to pay for imports.

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Transportation and Construction Decline

Reflecting both bottlenecks within the sector and the generally depressed state of industry, Polish freight transport declined by about 25 percent in first-quarter 1981 compared with the same period last year. Truck transport fell over 30 percent, rail transport declined 15 percent, and ocean transport was down about 20 percent. Transshipments also fell about 44 percent, probably reflecting at least in part the concern of CEMA countries about Polish reliability—even in shipping.

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The construction industry experienced a decline of more than 20 percent and a fall in labor productivity of 16 percent in the first four months of 1981 compared with January-April 1980.

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The Foreign Trade Record

Foreign trade performance in the first five months was almost certainly poorer than Warsaw expected. The slump in industrial and raw material production and the regime's emphasis on preserving output for domestic use contributed to an estimated 23-percent fall in hard currency exports compared with the same period a year ago. A similar 19-percent drop in imports held the trade deficit with the West to an estimated $220 million—somewhat above the $130 million deficit in January-May 1980—but crippled production and forced further drawdowns of stocks. (Seasonally adjusted trade in January-May shows a nearly $400 million deficit, see figure 3.) Conversely, imports from the Soviet Union jumped 15 percent, with the largest increase noted in the delivery of raw materials and consumer goods, while exports to the USSR dropped about 20 percent. As a result, Poland recorded an $870 million trade deficit with the USSR in January-May, considerably above the $30 million deficit reported in the same period last year. This trade deficit—in effect a Soviet trade credit to Poland—is one form of Soviet

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assistance to Warsaw. Poland's $160 million trade surplus with the other Warsaw Pact countries in January-April 1981 suggests that Moscow was picking up a larger part of Soviet Bloc aid to Poland early this year.

Food Shortages Continue

Food shortages in Poland remain severe and are contributing to labor unrest. The shortages—the worst in recent memory—stem mainly from the 7-percent drop in net agricultural production last year, but the situation has been aggravated by panic buying and hoarding earlier this year. Artificially low retail food prices accompanied by higher earnings, thanks to Solidarity, have also contributed heavily to the imbalance between supply and demand. In addition, shortages of coal have caused numerous work stoppages in the food processing industry.

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Consumption of meat and dairy products has now fallen more than 10 percent, January-May 1981 over January-May 1980. Potatoes, sugar, fruits, and vegetables are in short supply, and packaged goods have practically disappeared from store shelves. The urban population has been hit hardest as farmers retain more food for their own use rather than marketing it in urban areas. In addition, a larger proportion of total supplies is now handled through private and black markets at much higher prices. Many state stores are presently stocking grocery shelves with hardware equipment and household items for lack of food.

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The nationwide rationing of meat, butter, sugar, grain products other than bread, and infant food products has somewhat improved the equitability of food distribution and shortened queues. The system has been bogged down, however, by complicated and frequently changing rules. Some consumers are so dissatisfied they have petitioned for reform. Even more worrisome, the regime acknowledged earlier this month that meat rations for July can be provided only by using the remainder of meager state reserves and by importing 16 to 17 thousand tons of meat. Solidarity has reportedly expressed opposition to a government proposal to cut meat rations by 20 percent for an unspecified period of time. Informal, local rationing of most other foodstuffs and essential consumer goods continues to be widespread.

Although no one is going hungry, the shortage of food is so frustrating and exhausting to those who wait in lines that it adds considerably to the political and social tensions in Poland. The Poles have a tradition of hearty eating, an apparently insatiable appetite for meat, and spend about 40 percent of their disposable incomes on foodstuffs. Consequently, the availability of sufficient supplies of food at affordable prices is important to the maintenance of political, economic, and social stability in Poland. Several previous Polish regimes can trace their downfalls at least partly to public dissatisfaction with food shortages or food price increases. In 1981 food problems have resulted in occasional violent confrontations between consumers and store workers. In addition, widespread public dissatisfaction and the long hours spent by urban consumers waiting in line to buy food have increased worker absenteeism and measurably reduced labor productivity.

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Agricultural Outlook Generally Encouraging

Shortages of most foodstuffs are at least not likely to worsen this summer as seasonal products—fruits, vegetables, and potatoes—continue to come on the market. According to Polish Prime Minister Jaruzelski in mid-June, in the coming months "we have an opportunity for a relatively rapid improvement in supplies to the population of the basic food articles, with the exception of meat."

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As of early July, prospects for Poland's 1981 grain crop are good. If weather conditions remain favorable, the harvest is likely to total some 20-20.5 million tons—above average and well above last year's output of 18.3 million tons. This outlook is predicated upon an average winter grains harvest and above-average spring grains production.

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Continued favorable weather is forecast through mid-July.

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Prospects for Poland's major nongrain crops are favorable as well. Press reports indicated that the sowing plan for potatoes would be fulfilled because of a surplus of seed potatoes. Following the worst harvest in the postwar era, a good potato crop is needed to bolster the livestock industry; potatoes account for about 40

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percent of the hog feed in Poland. Cutting of the first hay crop—an important supplemental livestock feed—is nearing completion.

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Rapeseed is Poland's chief source of vegetable oil, and sugar beets are the country's principal source of sugar. A recent report of insect infestations in the rapeseed and potato crops in many areas, however, bears careful watching in light of the country's acute shortage of pesticides.

The favorable grain outlook results in part from promising steps the Kania government—keenly aware of the relationship between adequate food supplies and its own political survival—has taken to stimulate food production this year. These steps include substantial increases in farm procurement prices, stepped-up military assistance to agriculture, temporarily freezing most farm input prices, and legalizing Rural Solidarity.

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Still, hard currency constraints and endemic shortages of such vital inputs as fertilizers, pesticides, and spare parts for agricultural machinery are causing serious problems for the farm sector. For example, one-fifth of the country's tractor fleet is presently idled for lack of spare parts. Private farmers, encouraged by this year's higher agricultural procurement prices, will at least partially offset equipment shortfalls with extra labor input. The government has also temporarily cut sales of mixed feeds to farmers by 45 percent because of a shortage of imported grain.

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A good crop year would be especially significant for the livestock sector. The number of cattle dropped nearly 7 percent from January 1980 to January 1981, and hog inventories fell almost 11 percent during the same period. These declines, the largest since the mid-1970s, were caused mostly by a shortage of feed. Earlier this year, Warsaw indicated that even under the best of circumstances, it did not expect hog inventories to recover their June 1979 levels before 1982, or cattle inventories to recover before 1983. The squeeze on hard currency could further delay the rebound in livestock herds if cuts in imports of grain and protein supplements from the West offset this year's increased grain production. Furthermore, transportation and distribution problems may prevent full use of the grain that is imported. In the absence of substantial revisions in meat import plans, per capita meat consumption will drop more than 10 percent this year, to the lowest level since 1973.

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External Financial Squeeze

The 1980 strikes and the concessions that ended them not only accentuated the ongoing deterioration in domestic economic conditions in Poland but also forced the regime to abandon the prestrike priority given to improving the balance of payments. Consequently, although Warsaw did cut its hard currency trade deficit in 1980 to $1.0 billion from $1.7 billion in 1979, it fell far short of its original target of an $800 million surplus. In addition, the debt service burden mounted—with the debt service ratio reaching an alarming 88 percent—not only because of a continuing trade deficit but also because of the increasingly unfavorable maturity structure of the debt and the effect of higher interest charges. By the end of 1980, Poland's hard currency debt stood at $25.0 billion, up from $22.7 billion a year earlier.

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Poland entered 1981 facing a hard currency debt-service requirement (exclusive of short-term debt) of about $10.5 billion. It consisted of $4.0 billion in principal on unguaranteed loans, $3.6 billion in principal on government and government-backed (official) loans, and a total of $2.9 billion in interest payments. Warsaw also faced the threat of having to pay off at least part of its estimated $2 billion net short-term debt. Beyond debt service, Poland also required a relatively small but crucial amount of financing to cover a hard currency trade deficit that would be only partially offset by an anticipated net surplus on invisibles (exclusive of interest) of about $400 million. Calculated from Warsaw's projection of a $700 million trade deficit in 1981—presumably the gap Polish economists thought necessary to assure enough output to prevent economically generated unrest—the requisite credits would be $300 million. In fact, some Polish officials have privately indicated that a much larger trade deficit would be appropriate, implying a higher borrowing need.

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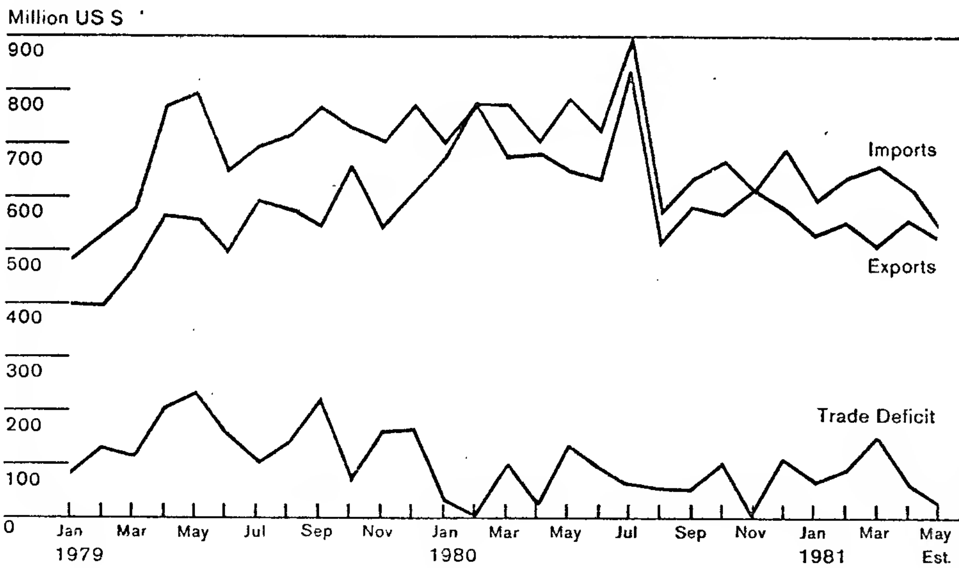
Figure 3

Poland: Trade With Non-Communist Countries[a]



[a]Converted to US dollars at current exchange rates. Official Polish trade data reported on a customs basis. Seasonally adjusted.

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Warsaw Tries To Avert Default

Poland managed to meet its foreign payments obligations in first-quarter 1981 with an estimated $700 million in hard currency aid from the Soviet Union and about $1.5 billion from Western governments. Seven of the latter agreed to provide "bridge financing" in the form of refinancing 60 percent of principal and interest payments due in the first quarter. Warsaw also received pledges of guaranteed credits for purchases of food, steel, chemicals, and other industrial inputs, as well as an EC package of food aid.

Although Poland was continuing to meet its debt service obligations, it had become evident in early 1981 that multilateral rescheduling would have to become the cornerstone of the Western rescue effort. Negotiations with Western governments on a longer term debt relief package began in February. As these negotiations picked up momentum, Warsaw's financial position deteriorated sharply. Western banks reduced Poland's short-term credit lines, and Warsaw started to miss payments. On 26 March Poland notified government creditors and Western banks that it could not meet principal payments but would pay interest on unguaranteed (though not on official) credits through June. The resulting arrearages were to be folded into the rescheduling agreements. Both official and private creditors have generally gone along with this informal moratorium, though major banks have had to exert pressure to ensure that one bank does not break ranks and trigger a general default through the mechanisms of cross-default clauses included in most loan contracts with Poland.

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Rescheduling Agreement With Government Creditors

When Poland in effect admitted bankruptcy in late March, its financing requirement for the rest of 1981 was on the order of $8.5 billion, not counting short-term debt (by then down to $1.4 billion). In late April it took a major step toward reducing the gap when it concluded a rescheduling agreement with 15 of its

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Western creditors. The arrangement provides debt relief of about $2.9 billion. The major items in the agreement include:

- Rescheduling of 90 percent of principal and interest on (a) official loans due from 1 May through 31 December, and (b) arrearages accumulated after 26 March. Both the grace and repayment periods are four years.

- Balance-of-payments targets, formulated by the Poles, which Warsaw is expected to meet. The targets call for the elimination of the hard currency trade deficit next year and achievement of balance on the current account in 1986.

- Suspension of rescheduling in the event of "exceptional circumstances." Though no formal commitments have been made, the creditor countries made clear that they will continue to reschedule official debt at least through 1983, barring a Soviet invasion or repressive action against the populace by the Polish regime. [redacted]

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Negotiations on the bilateral agreements to nail down the government rescheduling have gone slowly. Bilateral agreements were to be completed by the end of June, but only a few of the 15 creditors have signed because the Poles are rejecting the high interest rates Western governments are demanding. [redacted]

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Soviet Economic Assistance

Warsaw has also received sizable economic assistance from the Soviet Union this year, worth nearly $3 billion in both soft and hard currencies. Moscow has provided Warsaw with above-plan exports as well as price breaks in foreign trade. [redacted] Despite Polish claims of much larger sums, we estimate that the amount of hard currency assistance provided in 1981 totals about $700 million, much of it in the form of rollovers of payments due to Soviet banks. [redacted]

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Poland's other CEMA partners have been less generous. The other East European countries have provided little if any hard currency to Poland. Moreover, since the beginning of the year, they have not allowed Warsaw to run deficits in bilateral trade; the East Europeans are matching reduced Polish exports with a cutback in deliveries to Poland. [redacted]

The Remaining Financial Gap

Poland's 1981 financial gap at midyear is currently down to about $5.2 billion. In addition to the $2.9 billion in debt relief it received from the April rescheduling, Poland has apparently continued to meet interest payments on unguaranteed loans, reducing the gap by perhaps another $400 million in the second quarter. The uncovered amount consists of an estimated $3 billion in principal and $900 million in interest on unguaranteed loans, about $500 million in official debt service payments due the 15 Western countries but not included in the April agreement, about $500 million in official debt held by other countries, and about $300 million to cover a current account deficit exclusive of interest (provided the trade deficit actually ends up at $700 million as officially projected). [redacted]

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Poland stands a good chance of obtaining deferral on most of the $3 billion in principal it owes on unguaranteed loans. The complex rescheduling negotiations with Western banks on these loans have bogged down over differences among banks and with the Poles. US banks decided—and banks in Western Europe and Japan reluctantly agreed in late June—to put off negotiating a rescheduling agreement until December. In the interim, they intend to honor the informal moratorium on principal payments as long as Warsaw meets its interest obligations. Even if the December target is not met, the informal moratorium is likely to continue. The alternative of a formal default or unilateral moratorium is not in bankers' interests because it increases the risk that they will never be repaid. [redacted]

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The outlook for covering the remaining gap of more than $2.0 billion is more problematical. At this time there is little willingness on the part of the three potential sources of this new money—Western commercial banks, Western governments, or the USSR—to lend large sums to Poland. As a result, Poland's hard currency trade account was apparently

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forced very nearly into balance in May because of a lack of funds to purchase needed imports.

- Commercial banks are adamant in their refusal to increase their unguaranteed exposure in Poland. They are thus avoiding participation even in government-backed loans because banks must shoulder the additional exposure of the unguaranteed portion of the credit, usually about 15 percent. This is true even of the European banks, which are more willing than US banks to reschedule debts. Nearly all banks have reached their lending limit to Poland, and with Warsaw having stopped principal payments there is no room even to roll over credits as payments come due.

- In general, Western governments feel they have done enough for Poland by providing substantial export credit lines and bridge financing earlier this year, and by rescheduling Poland's official debt. They are thus unlikely to provide as much money as Warsaw wants. At a meeting in early June, Warsaw had hoped to line up additional new government credits. But official creditors gave Poland the cold shoulder. The only offer was $50 million from France, and that was conditional on credits from other countries. In recent weeks, Warsaw's search for funds has taken on an increasingly desperate character. There are reports that Warsaw is seeking $1.2 billion in Western government aid. Poland has asked France, West Germany, Great Britain, Italy, and Switzerland for an immediate loan of $500 million. France is pushing for a $500 million emergency loan. Most of the money would be used by the Poles as downpayments to enable them to tap a substantial volume of unused government-backed export credit lines. Poland is unlikely, however, to obtain more than a small fraction of the $500 million requested. In early July, Poland did get two aid commitments: Great Britain promised to guarantee $85 million in export credits for the rest of 1981 over and above previous commitments, and guarantees on FRG credits to Poland on West German exports will be raised from 85 to 95 percent.

- The Soviet Union might change its current position and agree to provide additional hard currency help in order to avert a Polish default that could damage the USSR's credit rating and that of the other Bloc countries. But Soviet funds for Poland apparently were exhausted in March, and the Soviets have told the Poles that none will be available for the remainder of 1981, or, on other occasions, until late 1981. We believe the Soviets, disenchanted with the Kania regime, will stick by their assertions. A new Polish regime, more to the USSR's liking, might have a better chance of getting Soviet help—but probably a correspondingly worse chance of obtaining aid from the West. 25X1

Unless the hard positions that creditors are currently taking soften, a substantial part of Warsaw's financial gap for this year will not be filled. Poland is thus faced with the choice of (a) formal default or a unilateral declaration of a debt moratorium, or (b) large adjustments in the trade account such as further wrenching cuts in hard currency imports. The alternative of a unilateral moratorium on debt repayments is reportedly advocated strongly within the Polish Politburo. In all these cases, politically dangerous adjustments would be required to bring the trade account into balance on a much reduced scale. If Warsaw elects to continue paying interest, a surplus on the trade account would be required. The impact on production and consumption would be severely disruptive—clearly threatening the viability of the Kania government 25X1

The Uncertain Future

Basic Strengths of the Polish Economy

Despite the severity of Poland's economic ills, several factors should help the country take advantage of the breathing space Western debt relief and credits would provide.

- Poland has the basic assets for righting the balance of payments and restoring the health of the overall economy. These include a skilled labor force, abundant natural resources, and a capital stock that a year of peaceful revolution has left underutilized but intact. If the critical industrial inputs are available and Polish workers can be motivated to move where they are needed and to work longer and harder, economic activity could revive. Since national income, in its third year of decline, is now expected to be at least 15 percent lower this year than in 1978,

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there is ample room for economic expansion from present levels through use of existing resources.

- Some of Poland's key exports—coal, copper, silver, sulfur, and agricultural products—are easily salable in the West. Poland can take advantage of the competitiveness of these products to boost exports.

- The agricultural sector—after suffering from years of neglect and ill-conceived policies—could benefit quickly from measures to encourage the private sector. The potential is there for sharp boosts in farm output, which could help cut the trade deficit and alleviate food shortages.

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Internal Preconditions for Economic Recovery
Poland, however, is still unable to take advantage of her basic strength because the Kania government has not yet established certain preconditions for an economic renewal.

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Worker Trust. As long as the populace views its leaders as self-serving, corrupt, and incompetent, it is unlikely to put forth greater effort on the production line or accept a standard of living that at best will rise only moderately over the next several years. The trust between leaders and led that economic recovery requires has not yet materialized, and there is no assurance that it ever will. Indeed, on the eve of the party congress labor strife has flared anew. Members of Solidarity staged a four-hour warning strike on 9 July at the national airline LOT and a one-hour strike in all ports on 8 July. In addition, transport workers in Bydgoszcz carried out a two-hour strike on 9 July to win dismissal of a city transport director. At issue for LOT workers is whether employees or the Ministry of Transportation should pick a new director for the airline. Unless the government accepts the employees' nominee, the workers reportedly will call a full strike on 24 July. Dockworkers are pressing for higher pay and better working conditions. There may be some room for optimism, however, if—after the party congress—the populace considers that prospects are better for institutionalizing some of its hard-fought political objectives.

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Though this month's outbreak of labor unrest suggests that the public's patience with shortages is wearing thin, the population has shown considerable tolerance for economic hardship in the last year. Its forebearance perhaps reflects (a) the new leadership's candid admissions that past mismanagement and corruption have left the economy a shambles, (b) its promises to rejuvenate the economy, and (c) satisfaction of some of the population's social aspirations—notably, formation of Solidarity.

Solidarity Support for Stabilization Program. Past abortive attempts to raise food prices without sufficient preparation or consultation with workers point up the importance of Solidarity cooperation. The government has promised to submit its reports on the state of the economy and the stabilization program to Solidarity. As consultations continue, Solidarity seems to be now focusing its attention more on bread-and-butter issues. For example, Solidarity now appears more willing to go along with moderate and gradual rises in retail prices if the government agrees to correspondingly adjust the incomes of lower paid workers and commits itself to serious economic reform. In addition, the regime must convince workers that their acceptance of higher prices will not simply shore up the old, inefficient system. At the same time, however, there is general agreement within Solidarity that the union will only comment on the government's suggestions on economic reform, rather than advance a rival program on its own. These developments—as well as the greater willingness of the government to negotiate with Solidarity on economic issues—provide a glimmer of hope. Solidarity, which has virtual veto power over the regime's economic policies, cannot be relied on, however, to support the tough austerity measures the economy may require. Indeed, it continues to withhold endorsement of the government's stabilization program. On economic reform, it is pushing hard only for a greater role for workers in enterprise management.

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Assertion of Central Control Over the Economy. Warsaw must impose discipline on the investment process, which is still characterized by local and ministerial defiance of central directives. For example, new projects continue to be initiated despite orders to concentrate funds on completion of work already under way. The success of the regime's agricultural policy depends on preventing local party officials from undermining programs to enhance the role of the private sector. Previous efforts to stimulate private agriculture

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have been done in to a large extent by such local subversion.

Warsaw's Economic Program

The closest approximation of a comprehensive long-range Polish economic plan is the series of stabilization programs Warsaw has issued this year. These documents were in large measure public relations efforts designed to convince Western creditors that assistance would not be wasted. The latest program—the fourth—was presented to Poland's official creditors in April. It contains not only promised reforms and policy measures, but offers projections of (a) trade and the balance of payments with both the West and the Communist world; (b) production and exports, in real terms, of several key commodities; and (c) growth rates of national income, industrial production, agricultural output, and investment. The targets, though ambitious, are not beyond fulfillment. The balance-of-payments projections—running through 1990—are viewed by the 15 Western creditor countries as targets the Poles are expected to reach in exchange for the debt relief accorded to Poland.

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The April program foresaw national income declining this year by 10 percent. (Warsaw now anticipates a 15-percent decrease.) A modest recovery is forecast after 1981, with national income slated to grow by about 2.5 percent annually in 1982-83. (External targets are discussed below.)

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In contrast to the production, growth, and payments projections, the policy and reform recommendations and promises are often vague and inconsistent—so much so that the program was rejected by the Sejm to which it was presented last spring. The program was submitted with little change to a 2-3 July Sejm session but is not expected to be approved until the end of July at the earliest. The regime's only concrete step in the direction of economic reform was a modest attempt to streamline the government by merging eight economic ministries into four and splitting the Ministry of Foreign Trade and Maritime Economy into two ministries.

Short-Term Policy Measures

The program, nevertheless, includes several policy measures that the regime seems determined to implement and that in fact would help to stabilize the economy and improve the balance of payments. In addition, these measures should not meet with opposition from the populace and have the added advantage that their implementation and impact can be easily monitored by Western creditors. These policy measures include:

- Selected cuts in hard currency imports (particularly of machinery and equipment) that will not impinge on consumer welfare or industrial activity.
- A continued sharp reduction—25 percent—in fixed investment in 1981, no change in 1982, and moderate growth thereafter so that by 1985 the share of fixed investment in national income will be only 10 to 12 percent compared with 17 percent in 1980.
- More rational allocation of reduced investment to help critical but previously neglected sectors such as agriculture, transportation, and electric power.
- Encouragement of private agriculture through legal steps to allow enlargement of individual holdings, more investment, a stepped-up flow of vitally needed imports, such as fertilizer, and easier availability of credit.

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In sum, the regime's basic economic strategy is to: (a) give priority to improving the balance of payments while avoiding a further decline in the standard of living by cutting investment and nonessential imports; (b) allocate investment along more rational lines; and (c) give encouragement to private agriculture to boost output in a long-mistreated sector that is vital to both the balance of payments and the standard of living.

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Longer Term Policies and Economic Reform

In the longer run, Warsaw realizes that many far-reaching and controversial reforms are needed to restore balance-of-payments equilibrium, improve economic efficiency, and resume economic growth. The most important and perhaps most controversial aspect of the program is its emphasis on austerity for consumers and the possibility of a temporary drop in the standard of living. Unless the government wins Solidarity's support and the workers' trust, the plan will probably meet with the same public opposition that ended the embryonic austerity plan of 1980. Also

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included are major reforms to decentralize management of industry, increase retail and wholesale prices, and link wages to productivity. If these reforms are to have the desired effect, however, their introduction may require some delay.

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Even though decentralization is essential to lasting improvement in economic efficiency in Poland, any premature relaxing of central control runs the risk that resources will be diverted to uses inconsistent with the demands of the balance of payments and the consumer sector. Likewise, any early raising of consumer prices by a sizable amount or a strict linking of wages and productivity—though good economic sense—could trigger popular discontent and even disturbances.

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Given the availability of much excess capacity, the regime's 1982-83 annual growth targets of roughly 2.5 percent seem attainable. Furthermore, restraining investment as planned would allow Warsaw to raise real per capita consumption by over 1 percent annually and still permit a reduction in the current account deficit.

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Hard Currency Balance-of-Payments Prospects

The Poles project a steady improvement in the hard currency balance of payments after 1981, culminating in a small current account surplus in 1986 (see table 3). In the meantime, Polish debt would increase from the yearend 1980 level of $25 billion to $35 billion by yearend 1986. The key to the anticipated turnaround in the current account is a substantial swing in the trade account. Warsaw's projections presuppose sufficient credits to permit a Polish trade deficit with the West this year. Poland plans on achieving balance next year and steadily rising surpluses thereafter. The improvement is predicated on an essentially constant volume of imports through the mid-1980s and average annual growth in real exports of about 6 percent.

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These export targets are clearly ambitious in light of Poland's difficulties in selling to the West—because of sluggish Western demand, trade barriers, and lack of competitiveness of manufactures—and its import dependency. For example, Warsaw cannot curtail the growth of imports of industrial raw materials, which are already at dangerously low levels, too long without jeopardizing its exports and economic recovery plans. Already, hard currency exports of many finished goods have decreased or been delayed in production because of import shortages. In addition, another poor harvest, failure to implement domestic economic stabilization measures, or unfavorable developments in world markets would certainly jeopardize Warsaw's chances for achieving its trade targets. Uncertainty also stems from political obstacles. Unless the regime stabilizes the political situation through accommodation with the labor movement, and convinces workers in the coal-mining industry in particular that economic progress depends on greater work efforts, the balance of payments will continue to deteriorate in the coming years.

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The Soviet Perspective

The USSR, meanwhile, has been watching with increasing alarm the deterioration in the Polish economy—and much worse, the crumbling of the Polish Communist Party. The Soviets have so far employed political and military pressure short of direct military intervention—apparently because it was the easiest, least costly course and because it still holds out hope of success. In deciding whether to intervene the Politburo will have to take into account:

- A need for the largest Soviet military operation since World War II.
- A long-term occupation by a sizable military force, a diversion that would complicate enormously Soviet security planning in Europe.
- An indefinite setback to detente in Europe, a critical strategic area.
- The large though uncertain price tag of invading and pacifying the country and of propping up the Polish economy.

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A Post-Invasion Poland

Probably the best the Soviets could hope for in the wake of intervention is for general passive resistance, with no one working hard. Production in Polish industry would decline rapidly as morale and productivity would reach new lows. Critical bottlenecks would soon appear in essential services such as transportation and distribution. Civilian disruptions would be made worse by the military's prior claim on the transport network. Widespread hoarding and the withholding of output by private farmers would add to the shortages. Finally,

Table 3

Billion US $

Poland: Projections of Hard Currency Balance of Payments

	1980 [a]	1981	1982	1983	1984	1985	1986
Current account balance	−3.19	−3.44	−3.00	−2.45	−1.87	−1.17	0.06
Trade balance [b]	−0.98	−0.70	0.00	0.70	1.40	2.20	3.40
Exports, f.o.b.	7.50	6.50	7.50	9.00	10.40	11.90	13.50
Imports, f.o.b.	8.48	7.20	7.50	8.30	9.00	8.70	10.10
Invisibles balances	−2.21	−2.74	−3.00	−3.15	−3.27	−3.37	−3.34
Receipts	1.88	1.88	2.03	2.31	2.56	2.85	3.16
Expenditures	−4.09	−4.61	−5.08	−5.46	−5.84	−6.21	−6.50
Interest on short-, medium-, and long-term credits [c]	−2.62	−3.13	−3.43	−3.63	−3.80	−3.96	−3.99
Gross financing requirement [d]	−9.00	−11.17	−9.34	−6.48	−5.08	−6.01	−6.75
Credits extended	−0.20	−0.20	−0.30	−0.30	−0.30	−0.30	−0.30
Repayment of medium- and long-term credits [c]	−5.61	−7.54	−6.04	−3.73	−2.91	−4.54	−6.50
Debt relief [e]		6.40	6.60	4.65			
Financial gap [f]		−4.77	−2.65	−1.82	−5.08	−6.01	−6.75
Other items:							
Change in asset holdings in Western banks	−0.21	0.04	0.11	0.09	0.09	0.05	0.15
Reserves at yearend	0.40	0.44	0.55	0.64	0.73	0.78	0.93
Gross medium- and long-term debt at yearend	22.94	25.93	27.93	29.46	31.63	33.10	33.34
Debt-service ratio (*percent*) [g]	88	50	29	23	51	57	63

[a] Estimated.
[b] Polish trade projections.
[c] Before debt relief.
[d] The gross financing requirement equals the sum of the current account balance, credits extended, and repayments of medium- and long-term credits.
[e] In 1981, we assume 90 percent of (a) official principal and interest payments due from 1 May to 31 December and (b) the arrearages on official debt accumulated before 1 May are rescheduled over an eight-year period (including a four-year grace period). In addition, we assume Soviet-owned banks in the West reschedule about $550 million over the same period. For Poland's unguaranteed debt, we assume 95 percent of principal payments due from 1 April to 31 December is rescheduled over a seven-and-a-half year period (including a four-year grace period), with an interest rate on rescheduled principal of 1.5 to 2.0 percentage points over LIBOR and with a 1-percentage point rescheduling fee. Additional funds Poland must raise to cover unrescheduled interest and principal plus the remaining hard currency account deficit are assumed to have an eight-year maturity (including a four-year grace period). In 1982-83, except for Soviet banks, we assume the same financing arrangements.
[f] Gross financing requirement less debt relief.
[g] Ratio of actual repayments of medium- and long-term debt plus actual interest payments on total debt to current account receipts. The projected ratio for scheduled debt service is 127 percent in 1981, 99 percent in 1982, and 65 percent in 1983.

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foreign trade probably would quickly grind to a halt. Even if Western shippers were willing to enter Polish waters, there would be no guarantee the ports would have the capacity to unload civilian cargoes or that the Poles would be working the docks. Acts of sabotage and damage to plant and equipment would of course make the economic plunge even steeper.

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Soviet costs in the months immediately following intervention would consist chiefly of maintaining the military effort in Poland, including repair of any damage done to the transport system and lost imports. Once the actual process of occupation was completed, the Politburo would have to decide how much aid to give. There is little question that Moscow would provide Poland sufficient support to help rebuild some degree of political stability and to minimize the effects of the crisis on CEMA trade and economic development. Moscow might decide to provide enough grain and other foodstuffs to keep Polish consumption from dropping precipitously and to provide whatever amounts of energy and industrial materials were needed to maintain economic activity at a fairly high level. Moscow probably would, at the very least, attempt to ensure that certain key Polish industries and mining operations were maintained. On the other hand, the Soviets would probably provide little if any help to Poland in meeting its hard currency debt service obligations. They would, however, not ask Poland to renounce the debt because of the implications for general East European creditworthiness but rather would quietly support Polish attempts to reach accommodation with Western creditors. The prospects for default would increase markedly, however, since Western governments and bankers would view the Polish regime unsympathetically.

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The Costs of Intervention

Uncertainty over Soviet intentions and the Polish response make any attempt to size the cost of an invasion meaningless. Taking into account the need to restore order and provide some floor for the Polish economy, we believe the costs would add up to much more than the $4 billion Moscow is already providing the Kania government this year in direct aid and trade subsidies. The Soviets, moreover, would have to reckon with the impact of military actions against Poland on the Soviet harvest and on the transport system. Soviet planners traditionally count on the military for help with the harvest, which begins in the western USSR in July. The pressure on the already severely strained rail system caused by a reallocation of rolling stock and vehicles from civilian to military use would compound the problem.

The economic cost of invading Poland could be raised greatly if the major Western allies imposed a new set of sanctions on the USSR. The effectiveness of sanctions would depend on the degree to which key countries in Western Europe and Japan participated. Moscow would judge—perhaps correctly—that the United States by itself could do little to hurt the USSR. But, although the USSR would also hope that allied cohesiveness would be weak and not last long, it cannot be sure. At a minimum the Politburo realistically could expect sanctions to extract a stiffer price than did the Afghan sanctions in 1980. Much may turn on how bloody a confrontation in Poland becomes.

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A sanctions effort limited to technology denials would not create much of a hardship simply because few large projects are on the horizon. The notable exception is the proposed gas pipeline from West Siberia to Western Europe. It would be an early casualty of Western sanctions, putting a mid-1980s startup date completely out of reach. A cutoff of day-to-day trade would be far more difficult for the Soviets to handle. Particularly painful for the USSR would be new restrictions on Western grain sales. Agreement among the United States, Canada, the EC, and Australia to limit sales would leave only Argentina as a potential supplier (although in the past Buenos Aires has stated it would consider joining an embargo if the USSR invaded Poland). Western denials of industrial goods would also be costly to Soviet planners faced with a growing gap between domestic production and needs for such key items as specialty steels and pipe and chemical feedstocks.

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The West could effectively double the impact of sanctions on the USSR by placing Eastern Europe under a sanctions umbrella. Indeed, putting the burden of additional support for Eastern Europe on the USSR's shoulders at a time of increasing domestic economic stringency would prove far more disruptive to Soviet plans and options than would Western measures directed solely against Moscow. To the Soviet requirement of at least 30 million tons of Western grain would

be added an East European requirement of about 15 million tons. Eastern Europe also depends on the West for substantial amounts of industrial materials and advanced machinery and equipment. In terms of impact, its denial would be a multiple of the actual value of the trade lost. Only by supplying the Bloc from Soviet production could Moscow replace foregone Western trade; even were the USSR willing, in a number of instances comparable replacements do not exist. [redacted]

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But economic measures against Eastern Europe also would be the toughest to obtain. All of the allies would be quick to note that it would undermine any movement toward greater liberalization in Eastern Europe, hurting countries the West has tried to wean away from Soviet dominance. [redacted]

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NSC BRIEFING MEMORANDUM

ECONOMIC AID TO POLAND

The Stakes

The fate of Poland's challenge to Soviet hegemony and communist orthodoxy -- a still embryonic development of potentially great strategic value to the West -- may depend largely on economic forces:

-- Before the Polish people have time to savor the new era of greater freedom, the new ruling triumvirate of reformist communists, independent unions, and the Catholic church must decide to impose economic measures aimed at arresting the country's economic deterioration and qualifying Poland to receive additional Western debt relief and new credits; this bitter medicine will be politically hazardous for the new leadership either to prescribe or to avoid. [redacted] 25X1

-- Within weeks of these critical Polish economic policy decisions, Western governments and banks must make a high-stakes decision of their own -- either to risk, by inaction, the economic undermining of Poland's challenge to Moscow or to undertake a prolonged, costly, and inherently speculative multilateral aid program to shore up Poland's capacity to preserve its independence. The strategic and political rewards for success could be the neutralization of the second largest military force in the Warsaw Pact and the loosening of Soviet control of all of Eastern Europe. Success cannot, however, be assured. [redacted] 25X1

-- The Soviet Union, without risking military intervention, may decide to impose severe economic sanctions, so as to nullify Polish recovery efforts supported by Western economic aid, thereby either inducing popular rejection of the new Polish political leadership or heightening anti-Soviet Polish nationalism, and in either case greatly increasing the cost of any rescue effort on the part of the Western powers. Trade sanctions would be awkward and costly to Moscow. [redacted] 25X1

-- Alternative projections also are strewn with perils. If the Soviets refrain from both military intervention and economic reprisals, and the Polish leadership refrains from profound economic measures, the West is unlikely to contribute substantially to the relief of Poland's critical

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Review on
July 6, 1987

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shortages; very quickly the resulting economic distress could explode in ways that create opportunities for successful Soviet suppression of Poland's flirtation with deviationism. On the other hand, if the new Polish leadership adopts austerity without fundamental reforms and persuades the West to respond with large-scale economic aid, Poland will escape immediate food riots but will remain indigent and vulnerable to Soviet economic pressure at times of Moscow's choosing.

Economic Factors in Brief 25X1

Poland's chronic economic illness, made critical by a year of strikes and governmental change, is evidenced by a projected 10-15% decline in GSP and shortfall of $11 billion in foreign exchange needed to service its $26 billion foreign debt and close its growing external trade gap this year. A generous rescheduling of payments due on official Western credits and the prospective rescheduling of debts to Western commercial banks will reduce the shortfall by nearly $6 billion. New Western offers of credit -- including $585 million scheduled to be provided by US banks under US Department of Agriculture guarantees to finance Polish imports of US grain -- total about $2.5 billion, but about 60% of the European credits are effectively frozen by financial terms which Poland appears to be unable to meet. If the Soviet Union and other Eastern European countries provide no more credits in the second half of 1981, Poland will need to borrow from the West an additional $2-$2.5 billion to finance food and other essential imports in the next six months. It will need credits with maturities averaging more than three years. 25X1

The need for official Western credits -- about $5 billion this year -- should decline somewhat next year if generous rescheduling of official and private debts continues and Poland is able to restore exports of coal and other goods. If all went well, Poland would be able to attract and service a rising proportion of commercial credits and reduce its need for official aid in 1983 and 1984. 25X1

Poland's need for Western aid would be increased significantly if preferential Soviet and other CEMA export pricing and payment terms on intra-bloc trading were withheld from Poland. Such economic sanctions could raise Poland's requests for Western aid by as much as $2 billion per year. 25X1

If Poland joins the IMF this fall, it could become eligible as early as mid-1982 for credit drawings up to 4.5 times its quota, or as much as $4.5 billion over three years.

Further details are contained in the attached State Department Staff Paper, "Poland: Can It Survive Until 1984?" (TAB B)

Western Aid Means

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Interagency staff discussions have found no basis for confident prediction of the will and capacity of the Polish political and union leadership to adopt and maintain an effective economic reform program. The outlook may be somewhat clearer after the Party Congress, but Solidarity's August convention may be more revealing. Moscow's response also should become clearer during and immediately after these pivotal Polish conventions.

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Western European governments have been taking a wait-and-see attitude toward Poland's appeals for economic aid. The new French government expressed readiness to help in raising $500 million in short-term credit from central banks (which the Federal Reserve has no legal authority to provide), but no European initiative commensurate with the economic need and political stakes has emerged. US representatives have been instructed to reject suggestions of a US lead in raising new credits, inasmuch as we already have done more than our share this year in purely economic terms as measured against historic trade and financial ties with Poland. We currently are considering how to respond to Poland's request for $80 million in longer than three-year credits to finance imports of US corn.

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If the Western allies decide to make either a gesture of support or a major and prolonged effort to support Polish independence, they will need to collaborate in order to achieve maximum political effect and assure equitable burden-sharing. IMF participation would greatly facilitate negotiation of economic policy conditions of aid and would reduce the fiscal burden on Western governments.

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Informal staff discussions have agreed that neither the regular instruments of bilateral economic aid (AID development assistance, PL480 credits and emergency grants, or security-related Economic Support Fund credits or grants) nor existing official export credit programs (ExIm Bank and CCC credit guaranties) are ideally suited to US participation in a possible multilateral aid consortium for Poland. A specially designed and legislated Polish aid instrument providing for financing of US grain exports to Poland, on repayment terms longer than existing CCC export credits and consistent with a possible IMF-Polish stabilization-recovery plan, is the preferred US instrument. The US loans might be conditioned on and

associated with Polish adoption of a comprehensive agricultural rationalization and development program. In acting on a large-scale aid package for Poland, the Congress might legislate its own policy stipulations. 25X1

If the Western allies were to launch a major program of economic support for Polish independence, their primary aim would be to serve allied military security objectives. While budgeted as foreign economic assistance, the US share might appropriately be funded by an offset against NATO theater or other defense programs.

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Decision Process

The Ottawa Summit, occurring immediately after the Polish Party Congress, offers the opportunity for private consultation on Poland at the highest political and economic levels among the major industrial nations. At that time, however, key facts required to make a firm assessment or decision will not be available.

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This matter should be kept on the NSC agenda for further consideration after the Ottawa Summit. Only after the critical political decisions have been made should the issue be entrusted to international economic decision processes.

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The 15 Western creditor governments participating in Polish debt rescheduling have formed with Poland a standing group, or "commission" at variable senior economic official levels which can meet to concert views in response to an expected Polish request for aid immediately after the Party Congress. If Poland joins the IMF this fall, this group could meet jointly with the IMF management and Polish government negotiators to review and respond to the initial Polish-IMF stabilization/reform program.

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